

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Uniform Issue List: 404.00-00

Contact Person:

Telephone Number:

199909058

In Reference to:

OP:E:EP:T:3

Date:

Att'n:

DEC 7, 1998

Legend:

Corporation A =

Corporation B =

Plan X =

Plan Y =

Fund M =

Dear

This is in reply to your ruling request of July 8, 1996, submitted on your behalf by your authorized representative, regarding the federal income tax consequences of proposed amendments to Plan X and Plan Y. The request was supplemented by letters dated October 31, 1997, November 26, 1997, April 9, 1998, September 15, 1998, and November 19, 1998. The following facts and representations have been submitted by your authorized representative.

Corporation B, a subsidiary of Corporation A established Plan X effective December 31, 1981, and Plan Y effective September 23, 1983. Plan X and Plan Y are qualified under section 401(a) of the Internal Revenue Code. Plan X and Plan Y each has an employee stock ownership (ESOP) feature as defined under section 4975(e)(7) of the Internal Revenue Code, and

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section 407(d)(7) of the Employee Retirement Income Security Act of 1974 (ERISA), and a Non-ESOP feature.

Under Plan X and Plan Y employees are permitted to make pre-tax and after-tax contributions. The maximum employee pre-tax contribution percentage is 8% of eligible compensation for highly compensated employees and 9% for non highly compensated employees. Employee contributions cannot exceed 20% of eligible compensation for highly compensated employees. Employee contributions which are eligible to be matched range from, 1% to 5% for employees with more than 10 but less than 23 years of service, and 1% to 6% for employees with 23 years or more of service. Twenty-five percent of the matched amount is contributed to the Non-ESOP portion and the other 75% is contributed to the ESOP account of each employee. In addition, each participating employer makes a contribution of 25 shares of Corporation A common stock to the ESOP account of each participating employee on active payroll who has at least 30 years of service as of April 1 of each plan year.

Under the terms of Plan X and Plan Y employees elect to invest their contributions and account balances in one or a combination of several funds, including Fund M, which consists solely of Corporation A common stock.

Corporation A proposes amending and continuing Plan X and Plan Y so that, effective January 1, 1998, Fund M under the Non-ESOP portion of Plan X and Plan Y will be added to the existing ESOP portions of Plan X and Plan Y and will constitute an ESOP described in section 4975(e)(7) of the Code. The term "ESOP account" as used herein, refers to any participant's account established pursuant to section 4975(e)(7) of the Code to which Corporation A stock has been allocated.

Also, effective January 1, 1998, Corporation A is amending Plan X and Plan Y to provide that any cash dividends paid with respect to Corporation A stock allocated to the participants' ESOP accounts will be distributed to participants as follows: Plan X and Plan Y will provide that on or before March 31 of each year, following the close of the plan year that ESOP dividends are paid, that the amount of such dividends may be distributed from the plans to the participants if elected by the administrative committee. Plans X and Y will provide that the administrative committee may elect to either:

- (1) Distribute the amount of all ESOP dividends for the plan year to all participants and all beneficiaries, while simultaneously providing all individual plan

participants and all individual beneficiaries an option to decline receipt of such dividends; or

(2) To distribute the amount of all ESOP dividends for the plan year to each participant and each beneficiary who elects to receive such dividends (such election to be provided to all participants and all beneficiaries).

The total amount contributed pursuant to an employee's election under section 401(k) of the Code to Plan X and Plan Y will not exceed the amount allowed pursuant to section 402(g) and total annual additions will not exceed the limits under section 415(c) of the Code.

Procedurally, Corporation A proposes that all ESOP dividends will be paid directly to the Trustee of Plan X and Plan Y and distributed to the participants directly by the Trustee of Plan X and Plan Y.

The appropriate Forms 1099 will be issued in regard to the above described dividend distributions.

Based on the foregoing, you request a ruling that the dividends paid on Corporation A stock held by Plan X and Plan Y that are paid directly in cash to the participants or to the trustee of Plan X or Plan Y and then distributed to the participants within 90 days of the close of the plan year will be deductible by Corporation A in the year distributed or paid under section 404(k) of the Code.

Section 404(k)(1) of the Code provides that, in the case of a corporation, there shall be allowed as a deduction for a taxable year the amount of any applicable dividend paid in cash by such corporation during the taxable year with respect to applicable employer securities. Such deduction is in addition to the deductions allowed under section 404(a).

Section 404(k)(2) of the Code provides, in relevant part, that the term "applicable dividend" means any dividend which, in accordance with the plan provisions is paid to the plan and is distributed in cash to the participants in the plan, or their beneficiaries, not later than 90 days after the close of the plan year in which paid.

Section 404(k)(3) of the Code provides that for purposes of this subsection, "applicable employer securities" means, with respect to any dividend, employer securities which are held on the record date for such dividend by an employee stock ownership

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plan which is maintained by - (A) the corporation paying such dividend, or (B) any other corporation which is a member of a controlled group of corporations (within the meaning of section 409(e)(4) which includes such corporation).

Section 1.404(k)-1T, Q&A 2 of the Temporary Income Tax Regulations provides that the deductibility of dividends paid to plan participants under section 404(k) of the Code is not affected by a plan provision which permits participants to elect to receive or not receive payment of dividends.

Section 404(k)(5)(A) of the Code provides that the Secretary may disallow the deduction under paragraph (1) for any dividend if the Secretary determined that such dividend constitutes, in substance, an evasion of taxation.

Based upon your representations, the subject dividends on Company A stock allocated to the plan participants' ESOP accounts will be paid to the plan participants within 90 days of the close of the plan year, if they do not elect to have the dividends retained in Plan X.

Accordingly, we conclude that the dividends paid on Corporation A stock held by Plan X and Plan Y that are paid directly in cash to the participants or to the trustee of Plan X or Plan Y and then distributed to the participants within 90 days of the close of the plan year will be deductible by Corporation A in the year distributed or paid under section 404(k) of the Code.

The above ruling is based on the assumption that Plan X and Plan Y will be qualified under sections 401(a), 401(k), 409, and 4975(e)(1) of the Code, as applicable, and the related trusts will be tax exempt under section 501(a) at the time that the above transaction takes place. In addition, we are assuming that the subject shares allocated to the participants' Plan X and Plan Y accounts are "applicable employer securities", within the meaning of section 404(k)(3) with respect to the subject dividends. We are not expressing any opinion as to whether the language of any particular amendment conforms to the requirements of sections 401(a), 401(k), or 4975 of the Code.

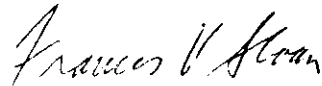
This ruling is also based on the assumption that the proposed dividend does not constitute, in substance, an evasion of taxation within the meaning of section 404(k)(5)(A) of the Code. We are expressing no opinion as to whether or not the disallowance of deductions provided for in that section would be applicable here.

19990905

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A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,



Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures:

Deleted copy of letter
Notice of Intention to Disclose

CC: